

APR 01 2005



US Oil & Gas  
Association



April 1, 2005

Department of the Interior  
Minerals Management Service  
Attention: Rules Processing Team  
381 Elden Street, Mail Stop 4024  
Herndon, Virginia 20170-4817

**Re: Increasing Base Rentals and Sliding Scale Rentals in Gulf of Mexico (GOM) Lease Sales; 70 Federal Register 10111-10112 (March 2, 2005)**

The American Petroleum Institute (API), Independent Petroleum Association of America (IPAA), Offshore Operators Committee (OOC), National Ocean Industries Association, and US Oil & Gas Association (USOGA) appreciate the opportunity to respond to the Minerals Management Service (MMS) request for comments regarding the agency's consideration of a possible increase in base level rentals for all newly issued leases in the Gulf of Mexico (GOM) and the implementation of a sliding scale component for rentals on leases located in deepwater. These five associations represent thousands of energy companies engaged in all aspects of the offshore oil and natural gas industry, including the majority of companies that hold most of the oil and gas leases found in federal waters of the Gulf of Mexico (GOM), and therefore have a direct interest in this matter.

Industry does not believe, as a matter of policy, that increasing rentals will necessarily result in increased exploration and development in the Gulf of Mexico. Industry prefers that rental rates remain the same for leases in both the shallow (200 meters or less) and deepwater (more than 200 meters) Gulf of Mexico. However, industry understands that increasing rental rates to adjust for inflation and compensate for changes in the economy are generally reasonable and expected. MMS proposes to increase the rental on leases located in the shallow waters of the Gulf from \$5.00 to \$6.25 per acre—the first adjustment since 1993. Although this proposed increase represents a 25% increase over existing rates and is greater than the calculated inflation rate since the last shallow water rental increase, the proposed new rate is not excessive and should not generally adversely impact future leasing activity in the shallow waters of the Gulf.

The proposed increase in rentals for deepwater leases together with the addition of a sliding scale raises serious concerns. MMS proposes to increase base rentals, on a non-escalating basis, from \$7.50 to \$9.50 per acre—a 26.67% increase. When the sliding scale component is

added to the proposed lease rental rate on deepwater leases not drilled during their primary term, the actual rental increase is 55.67%. In real dollars, this means that the cost of holding an un-drilled GOM deepwater lease after acquisition for ten years would cost the lessee \$672,480, compared to the \$432,000 a lessee pays today, an increase of \$240,480 per lease.

Industry considers the sliding scale component to be excessive. Escalating the rentals in the sixth year the primary term of the lease does not recognize the geologic complexity of ultra-deep targets and sub-salt structures that are common in the high potential plays in the deepwater Gulf of Mexico. MMS states that part of the justification for suggesting a sliding scale component for deepwater leases is to “encourage exploration drilling in deepwater areas earlier in the lease term.” While this may seem logical in theory, this proposed increase could result in fewer tracks receiving bids, fewer leases issued, and fewer wells drilled as a result of much higher carrying costs to lessees to maintain a large inventory of leases.

Historically, lessees have attempted to purchase leases in deepwater areas where the greatest potential exists for commercially successful discoveries of oil and/or natural gas. In new frontier areas, where there are few if any existing wells from which to derive important pre-drill data, purchasing a significant number of leases in any given geological trend gives lessees the ability to pursue additional drilling opportunities if an initial exploration drilling is successful. The suggested increased rates could lessen an operator’s flexibility in evaluating these prospects—as the operator would have less time to conduct a systematic, in-depth review—and could result in early lease terminations. For example, if a lease were terminated and re-leased, the “clock” would start again and the operator (same or new one) would have to work to evaluate the exploration potential of that lease compared to other leases in the lessee’s portfolio. If the cost of building these “trend lease inventories” becomes too great as a result of increased deepwater rental rates, lessees will also experience substantial increases in the costs of maintaining this inventory compared to current lease inventory levels. Implementation of a sliding scale component on deepwater rentals would also adversely impact trend leasing by imposing significant carrying costs on lessees for maintaining these leases.

The proposed sliding scale rental rate appears to be burdensome from an administrative standpoint and could result in reporting and accounting errors. As proposed, the annual rate changes begin at lease mid-term and are affected by time-sensitive or event triggers (e.g., discovery in paying quantities, start of production). These variables on multiple leases with different timelines could be difficult to recognize and administer in a consistent manner and would require accurate and timely communications throughout between MMS and the operator. Finally, there are few drilling rigs in the GOM fleet that are capable of drilling in ultra-deep waters, so rig availability could potentially further delay a lessee from executing a drilling program and result in higher costs under the sliding scale component.

In summary, while adjusting rentals to compensate for changes in inflation or the economy may be expected, industry suggests that implementing rental increases for deepwater leases beyond a fixed rate would penalize potential lessees—those who assume the risk and invest large amounts of capital to explore these frontier areas. Industry urges MMS to eliminate any sliding scale rental component to deepwater leases and only adjust rental rates for shallow and deepwater leases to a reasonable fixed level during the primary term. Since the Central and Western Gulf of Mexico provides about 25 percent of the nation’s natural gas production and about 30 percent of domestic oil production, we urge MMS to look for other ways to encourage exploration and development activities in the Gulf region, including consideration of all OCS areas in the next Five-Year Plan.

Industry appreciates the opportunity to offer these comments. Please direct any inquiries to Ms. Linda Bauch, American Petroleum Institute, 202-682-8170.



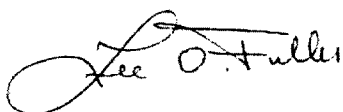
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American Petroleum Institute



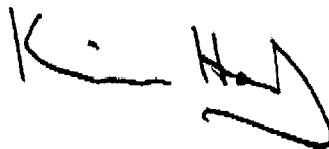
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US Oil & Gas Association



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Independent Petroleum Association



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National Ocean Industries Association

***Allen J. Verret***

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Offshore Operators Committee